

Press Release

26 July 2016

Completed investigation

On 14 July 2016, the FRC adopted the investigation report on the audits of the consolidated financial statements of a listed entity for the years ended 30 June 2007 (**the 2007 Audit**), 30 June 2008 (**the 2008 Audit**), 30 June 2009 (**the 2009 Audit**) and 30 June 2010 (**the 2010 Audit**).

The Audit Investigation Board (**the AIB**) found that the auditor failed or neglected to observe, maintain or otherwise apply a number of professional standards in the 2008 Audit, the 2009 Audit and the 2010 Audit. The AIB also found that the engagement partner failed to act diligently according to the applicable technical and professional standards in the 2008 Audit, the 2009 Audit and the 2010 Audit.

The investigation report has been referred to the Hong Kong Institute of Certified Public Accountants (**the HKICPA**) to determine if any disciplinary actions are warranted.

On 12 September 2013, the FRC directed the AIB to conduct an investigation on the 2007 Audit, the 2008 Audit, the 2009 Audit and the 2010 Audit.

As a result of the investigation, the AIB had the following findings:

(a) The 2007 Audit

The auditor claimed that the audit working papers relating to the 2007 Audit were destroyed in accordance with their file retention policy. Consequently, it was not possible to carry out any investigation into the 2007 Audit.

(b) Prepayments to three suppliers

The prepayments to three suppliers at 30 June 2010 were a significant line item which should have given rise to a heightened awareness by the auditor

as to its audit significance. However, the auditor failed to properly perform analytical procedures to plan the audit in accordance with paragraph 15 of Hong Kong Standard on Auditing (**HKSA**) 200 (Revised) *Objective and General Principles Governing an Audit of Financial Statements* (**HKSA 200**), paragraph 10 of HKSA 315 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (**HKSA 315**) and paragraph 8 of HKSA 520 *Analytical Procedures* (**HKSA 520**), and concluded at the planning stage that no significant risks had been identified and this line item was of low risk in the 2010 Audit.

The auditor also failed to obtain sufficient appropriate audit evidence to address the unusual nature of these prepayments identified during the 2010 Audit in accordance with paragraph 2 of HKSA 500 *Audit Evidence* (**HKSA 500**) and did not prepare sufficient audit documentation in accordance with paragraph 9 of HKSA 230 *Audit Documentation* (**HKSA 230**).

(c) Prepayments made to the major customer

The prepayments to the major customer at 30 June 2009 were a significant line item and there was material movement in this item between the years ended 30 June 2009 and 30 June 2010, which should have given rise to a heightened awareness by the auditor as to its audit significance. However, the auditor failed to properly perform analytical procedures to plan the audit in accordance with paragraph 15 of HKSA 200, paragraph 10 of HKSA 315 and paragraph 8 of HKSA 520 in the 2009 Audit and the 2010 Audit. The auditor also did not adequately perform the risk assessment procedures in accordance with paragraphs 55, 100 and 101 of HKSA 315 in the 2009 Audit and the 2010 Audit.

During the 2010 Audit, the auditor discovered unusual transactions in relation to these prepayments. However, they failed to update and change the planning decision, including risk assessments, in accordance with paragraphs 16 and 17 of HKSA 300 *Planning an Audit of Financial Statements*. In addition, the auditor failed to obtain sufficient appropriate audit evidence to support the amortisation of prepayments in accordance with paragraph 2 of HKSA 500 in the 2009 Audit and the 2010 Audit.

(d) Sales to the major customer

Planning

The auditor failed to, in the 2008 Audit, the 2009 Audit and the 2010 Audit,

- properly plan the audits with an attitude of professional skepticism in accordance with paragraph 15 of HKSA 200;
- properly perform their analytical procedures in accordance with paragraph 10 of HKSA 315 and paragraph 8 of HKSA 520; and
- justify the risk of material misstatement for revenue in accordance with paragraphs 100 and 101 of HKSA 315.

Consideration of fraud in revenue recognition

The auditor failed to assess the presumed risks of fraud in revenue recognition in accordance with paragraphs 57 and 60 of HKSA 240 *The Auditor's Responsibilities to Consider Fraud in an Audit of Financial Statements* in the 2008 Audit, the 2009 Audit and the 2010 Audit.

Tests of controls

The auditor failed to obtain sufficient appropriate audit evidence that the controls on recognition of sales of goods to the major customer were operating effectively during the years ended 30 June 2008 and 2009 in accordance with paragraph 23 of HKSA 330 *The Auditor's Procedures in Response to Assessed Risks* (**HKSA 330**).

In addition, the auditor had identified certain deviations in the application of the internal controls in the 2010 Audit. However, they did not perform any alternative audit procedures to address these deviations and failed to evaluate how these deviations affected the risk assessment in accordance with paragraph 66 of HKSA 330.

Substantive procedures

The auditor failed to, in the 2008 Audit, the 2009 Audit and the 2010 Audit,

- obtain sufficient appropriate audit evidence to support the revenue recognition in respect of the sales of goods to the major customer and the related trade receivables in accordance with paragraph 2 of HKSA 500; and
- properly perform the analytical review as an overall review of the relevant financial statements at the completion stage to identify the unusual sales transactions with the major customer in accordance with

paragraph 15 of HKSA 200, paragraph 17 of HKSA 520; and paragraph 11 of HKSA 550 *Related Parties*.

(e) Code of ethics

Based on the above, the engagement partner of the 2008 Audit, the 2009 Audit and the 2010 Audit failed to act diligently according to the applicable technical and professional standards in accordance with section 130.1 of the Code of Ethics for Professional Accountants.

(f) Consolidation of two subsidiaries

The results of two subsidiaries were not material to any of the financial statements for each of the years ended 30 June 2008, 30 June 2009 and 30 June 2010, and consequently the AIB has decided not to pursue this matter further.

(g) Engagement quality control review

The engagement quality control reviewer failed to record his performance of the engagement quality control reviews on the 2008 Audit, the 2009 Audit and the 2010 Audit and the completion dates of his reviews in accordance with paragraph 23 of HKSA 230.

The engagement quality control reviewer also failed to identify the above audit deficiencies during his engagement quality control reviews in accordance with paragraphs 38 and 39 of HKSA 220 *Quality Control for Audits of Historical Financial Information*.

On 14 July 2016, the FRC adopted the investigation report prepared by the AIB, which summarised the findings of the investigation. The investigation report has been referred to the HKICPA to determine if any disciplinary actions are warranted. Names of the relevant parties are withheld pending the conclusion of such disciplinary proceedings, if any.

The AIB is chaired by the Chief Executive Officer and its members are full-time staff of the FRC.

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Note to editors

About the FRC

The FRC is a statutory body established in December 2006 under the Financial Reporting Council Ordinance. The FRC is entrusted with the statutory responsibilities to conduct independent investigations into possible auditing or reporting irregularities in relation to listed entities and to enquire into possible non-compliance with accounting requirements on the part of listed entities. The FRC has 11 members with a variety of professional backgrounds and the majority of whom, including the Chairman, are lay persons. For more information, please visit www.frc.org.hk.

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